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SENSITIVE
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NSC FOR JIM LOI
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E.O. 12958: N/A
TAGS: ECON ETRD EFIN WTRO CH
SUBJECT: CHINA ACTS TO BOOST EXPORTS, SUBSTITUTE FOR
IMPORTS

REFS: A.) Beijing 0433 B.) Beijing 0151 C.) Beijing
0326 D. Beijing 0425 E.) Beijing 0443 E.) Beijing
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(U) This cable is Sensitive But Unclassified.
Please protect accordingly.

¶1. (SBU) Summary: In the past few months, China has implemented an array of measures at the national level designed to boost exports, promote use of domestic products and dampen demand for imports (Ref A). In some sectors (textiles, steel, light industry and petrochemicals, and machinery), the measures complement industrial restructuring programs that seek to expand domestic demand, protect employment, and revitalize industries hit hardest by the global financial crisis (Reftels B-G). The new measures include new export restrictions on key inputs to steel production, elimination of duty-free status for some imports, increases in export value-added tax (VAT) rebates and other measures to improve export competitiveness on a wide range of goods, and regulatory reforms to help exporters. These moves, while not necessarily WTO non-compliant, when combined with a proliferation of "buy local" preferences at the sub-national level (Ref H), raise questions as to whether China's evolving response to the global financial crisis adheres to the spirit and the letter of the its November 2008 pledge at the G-20 Summit to avoid new barriers to trade and investment. End Summary.

Keeping Input Prices Low by Restricting Exports

¶2. (SBU) In recent months, MOFCOM and other State entities including the Tariff Commission and General Administration of Customs have acted to restrict key primary exports, especially those related to steel production. Quotas or taxes on exports of these inputs are designed to suppress domestic prices and ensure supply of the inputs to producers and exporters of downstream products that heavily use these inputs. The effect is particularly acute on inputs for which China is the major global supplier. For example, China controls roughly sixty percent of

the global trade volume in coke and China is also a key exporter of phosphate ores. Major new actions affecting trade in coking coal, phosphate ores, and certain manufactured goods (November - present) are:

-- Phosphate Ores: establishment of an export quota of 1.5 million tons on phosphate ore and other measures (Ministry of Commerce, announced November 10, 2008; effective January 1, 2009);

-- Ores: levying of an export tariff on 15 products including barites, not chemically pure magnesium oxide, talc, brown fused alumina cobalt tetroxide, and some fluoride products. (Notice of the Tariff Committee of the State Council concerning Adjustment of Export Tariff (Shui Wei Hui [2008] Number 36 announced November 13, 2008; effective December 1, 2008);

-- Coke: reduction in the 2009 initial export quota allocation for coke to 5.78 million tons, roughly 40% below the comparable period in 2008 (Ministry of Commerce, announced December 30, 2008; effective January 1, 2009) [Note: While coke quota cuts went beyond what was expected, they may not be filled due to declining world demand. MOFCOM officials have indicated to Emboff that the 2009 coke quota may yet be revised upward when the next quota announcement is released mid-year. End Note.]

Cutting Exporters' Costs

¶3. (SBU) China has also lifted or reduced export restrictions on some finished and semi-finished products in an effort to improve the price competitiveness of Chinese exports:

-- Export tariff eliminations: removal of export tariffs on 102 products, including steel products (cold and hot rolled plate, strip, wire, large steel sections, alloy steel products and welded pipes; chemical products (ammonium nitrate, ammonium sulfate, and grain products (including corn, coarse cereals and their powders); (Notice of the Tariff Committee of the State Council concerning Adjustment of Export Tariff (Shui Wei Hui [2008] Number 36 announced November 13, 2008; effective December 1, 2008);

-- Export tariff reductions: reduction in export tariffs on 23 other products, primarily chemical fertilizers and raw materials, some aluminum products, wheat and rice and their powder; a reduction in special export tariffs on nitrogenous fertilizer and phosphate fertilizer and some raw materials (total of 31 products); (Notice of the Tariff Committee of the State Council concerning Adjustment of Export Tariff (Shui Wei Hui [2008] Number 36 announced November 13, 2008; effective December 1, 2008);

Eliminating Import Duty Waivers

¶4. (SBU) In December, the State Council released a revised "Catalogue of Products for Domestic Investment Projects Ineligible for Duty-Free Import" that adds 36 types of equipment to a list of imports no longer eligible for duty-free status when used in investment projects. (State Council, Notice of the Tariff Commission of the State Council Concerning Tariff Implementation Plan in 2009 (Shui Wei Hui [2008] No. 40 announced December 15, 2008; effective January 1, 2009 (2008 Adjustment) released jointly December 17, 2008 by Ministry of Finance, National

Development and Reform Commission, General Administration of Customs and State Administration of Taxation). The State Council notice justified the change by asserting that domestic products are sufficient to meet current demand in the following areas:

-- agricultural machinery

-- petrochemical equipment

-- coal mining equipment

-- power transmission equipment

-- port machinery

-- air-borne equipment

-- testing instruments

-- digitally controlled machine tools

[Note: Embassy understands that the import tariffs on products in the revised catalog are not necessarily "increased." The prevailing tariff rate remains the same, but domestic projects are required to pay the full amount instead of benefiting from an import tariff exemption as was the case previously. End Note.]

VAT Rebates on Manufactured Goods Increased to Spur Exports

¶5. (SBU) China levies a VAT on all domestic and imported input purchases, as well as all processing,

repairing and replacement services at either 13% or 17% level, and subsequently refunds a varying amount of that tax for goods exported. Increases in export VAT rebates are intended to favor designated sectors and may also be used to direct and monitor economic activities. As part of its ongoing VAT reforms, China increased VAT rebates on a variety of items at least three times in 2008: in August, November and December and twice in 2009 as well. The Ministry of Finance explained one of the larger rebates hikes by noting that "The move will help ease the sufferings of Chinese exporters and boost the country's confidence in fighting the financial crisis." Most recent increases in VAT rebates include:

-- February 2009 - Textiles: Export VAT rebates on textile and apparel products increased from 14 to 15 percent, following on from three prior increases in ¶2008. At the time, MOFCOM stated that the purpose of the increase was to reduce exporters' costs and support the textile industry. (Ministry of Finance Cai Shui [2009] Number 14, announced February 5, 2009; effective date retroactive to January 1, 2009.)

-- January 2009 - Electronics: Export VAT rebates were increased on a broad range of electronic and high-tech goods, including 553 types of high-tech and high value-added products ranging from industrial robots to aviation navigation systems as well as motorcycles and sewing machines. Rebates for inertial navigation instruments for airplanes, gyroscopes, instruments and apparatus for measuring or detecting ionizing radiations, nuclear reactors and industrial robots from 13 percent or 14 percent to 17 percent; motorcycles, sewing machines and electric conductors from 11 percent or 13 percent to 14 percent (Ministry of Finance, Cai Shui [2008] Number 177 dated December 29, 2008; effective

January 1, 2009.)

-- December 2008 - Labor-Intensive Goods: To help support industrial restructuring, export VAT rebates were increased on a diverse range of 3,770 labor-intensive products estimated to represent 27.9 percent of the country's total exports. Products include: rubber and forestry goods (from 5 percent to 9 percent); moulds and glassware (from 5 percent to 11 percent); certain aquatic products (from 5 percent to 13 percent); carry bags, footwear, hats, umbrellas, furniture, bedding products, lights and clocks (from 11 percent to 13 percent); chemical products, stone, nonferrous metal products (from 5 percent or 9 percent to 11 percent or 13 percent); some electromechanical products (from 9 percent to 11 percent, or from 11 percent to 13 percent, or from 13 percent to 14 percent (Ministry of Finance, Cai Shui [2008] Number 144 dated November 17, 2008; effective December 1, 2008.)

In addition, the State Council in this period confirmed in VAT interim regulations that there is a blanket presumption that "for taxpayers exporting goods, the tax rate shall be 0 percent, unless otherwise specified by the State Council." (State Council Decree Number 538 "Interim Regulations of the People's Republic of China on Value Added Tax", dated November 10, 2008, effective January 1, 2009).

Lifting Restrictions on Re-exports

¶6. (SBU) In another move to promote exports, starting February 1 some 1,730 ten-digit tariff lines were removed from the export-restricted catalog of the Ministry of Commerce and General Administration of Customs (Notice Number 44 [2007]) "Catalogue of Commodities Prohibited for Processing Trade", lifting prior restrictions on these low-value-added exports by allowing them to be imported

on a bonded basis free of customs duty and VAT if bound for re-export. Products deleted from the catalog and therefore eligible for processing trade include plastic material products, plastic products, wood products, and textile products. After the adjustment, export-restricted commodities comprise 500 tariff lines which include 106 commodities restricted for export and 394 commodities restricted for import. (Ministry of Commerce and General Administration of Customs Notice 120 [2008] announced December 31, 2008; effective February 1, 2009).

¶7. (SBU) Comment:

China's response to the global economic slowdown is comprised of three main parts: a large (USD 600 billion) simulus package focused primarily on infrastructure spending; implementation of ten industry support/revitalization plans to help key sectors affected by the slowdown; tax relief primarily for business and the series of measures described above intended to promote exports, ease costs of producers in the export sector and reduce imports. China's economy remains a transitional one dominated by national and local-level state-owned enterprises (SOEs). The trade-related measures detailed above all serve to bolster exports in the face of China's rapidly declining export sector. While none of China's policy response to the economic slowdown appears blatantly inconsistent with its WTO commitments, the moves do raise concern over whether China is complying with the spirit and letter of its November 2008 commitment at the G-20

Summit to avoid new protectionist actions.

¶8. (U) This cable was compiled with contributions
from Embassy economic elements including Econ, FCS,
ITA/MAC, and USTR.

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